STATEMENT BEFORE THE HOUSE COMMITTEE ON BANKING AND FINANCIAL SERVICES SUBCOMMITTEE ON CAPITAL MARKETS, SECURITIES AND GOVERNMENT SPONSORED ENTERPRISES

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BY

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I want to begin by thanking Chairman Baker and Ranking Member Kanjorski for this extraordinary opportunity. Your leadership and your willingness to work in bi-partisan fashion to do what's right for the Nation's communities is highly noteworthy.

Let me add that it's an honor to represent Secretary Cuomo at this hearing today. The Secretary is strongly committed to the America's Private Investment Companies (APIC) proposal and, more broadly, he has made the expansion and enhancement of HUD's economic development tools a high priority of his tenure, both as Assistant Secretary and as Secretary at HUD. I should add that he is very pleased with the progress we made this year with the Appropriations Committee and leadership in getting APIC funded, with pending authorization, of course.

I now want to provide the highlights of this important proposal, which was made by the President earlier this year and introduced in the House by Representative LaFalce and co-sponsors as HR 2764, the "America's Private Investment Companies Act."

As you know, this APIC bill reflects the hard work of many. At Secretary Cuomo's direction, it was organized by HUD policy staff, including Xavier de Souza Briggs, our Deputy Assistant Secretary, who has joined me as a witness today and will be available to answer questions after I've delivered this testimony, working together with the White House National Economic Council under the President's Senior Advisor, Gene Sperling. Also involved were the Small Business Administration, which has had a successful venture capital program to finance small businesses for many years now, and the Treasury Department, which worked with Congressional leaders to propose the New Markets Tax Credit this year. In the case of APIC, the New Markets Tax Credit, the New Markets Venture Capital Companies proposal, and the other elements of the Administration's New Markets Initiative, the process also included a dialogue with Congressional leaders and staff, leaders in the investment world, local economic development experts, state and local elected officials, and community-based organizations active in the job creation and community capital arenas. Like the proposed APIC investment funds themselves, the process was a partnership. We insisted on, and we are presenting to you, a non-bureaucratic program that grew out of this process.

The reason we worked so hard at this is simple: we believe that America's extraordinary economic expansion of the last six years presents us with an historic opportunity. We have the resources in this record-breaking economy, we have the financial tools and capital markets to make a difference, and we have the leadership. As you know, just last week, Speaker of the House Dennis Hastert and President Clinton stood up together to announce a commitment to work together to enact the best of each party's agenda for fighting poverty, empowering communities, minimizing government bureaucracy, and tapping new markets in places that are too often left behind by the rising tide. We appreciate the proposal put forward by Congressmen Watts and Talent, and we want to work with them to achieve common goals.

The Secretary has echoed this repeatedly, and when he had the honor of joining the President and you, Representative Kanjorski, on the New Markets Tour this past summer—I should note that Ranking Member Kanjorski joined for all stops on both tours—the message from the private sector was very clear. Talking with corporate CEOs, leading bankers, and others at the Pine Ridge Indian Reservation, in Appalachia, and in other distressed communities, it was clear to the Secretary that the "captains of capital" are ready for a bold vehicle that helps the private sector make major equity investments that empower low and moderate income areas of our country. This is precisely the role of APIC.

Now, backing up for a moment, what are "new markets"? When I speak of new markets, I mean low and moderate income communities where attractive opportunities exist to establish or expand businesses, places where gaps in information and capital access get in the way.

In this context, APIC is a simple idea—it is venture capital for these places left behind. It would stimulate the creation of private investment companies making market-driven decisions about investment in low and moderate income areas of our Nation, both urban and rural. About 35 percent of the Nation's population lives in the census tracts that would be targeted under the proposed poverty and income criteria, which also drive the New Markets Tax Credit and other elements of the New Markets Initiative. To complement the existing SBA program to provide venture capital to small businesses, APIC would focus on large-scale businesses.

The private investment companies licensed by HUD under this program could finance a wide array of project types, from retail centers, industrial parks, and other forms of commercial real estate to back office call centers, equipment upgrades at manufacturing facilities, and more so long as the targets of investment are active businesses that employ people—and to the greatest extent possible, people in low and moderate income communities. The licensed investment companies could even act as "funds of funds," investing in other capital funds that, in turn, invest in active businesses.

APIC adapts and expands on models that work—in particular, the Small Business Investment Companies (SBIC) program at SBA. The SBIC program has a simple, focused goal: to increase the availability of private equity capital for small businesses, also increasing the ability of these small companies to obtain additional capital, including bank loans. So the program recognized that equity, the first money into a deal and the first at risk, is the money that often makes an investment "bankable" in the sense that it becomes a good bet for a bank loan.

Like that program for smaller businesses, APIC would license qualified fund managers who come forward with an investment strategy and equity commitments from investors. The licensed investment companies are then eligible for an allocation of

Federally guaranteed debt on a ratio of two to one (or, in the case of high performers, up to three to one). So $25 million in equity leverages $50 million in debt, and this debt, borrowed at below-market rates because of the full faith and credit backing of the U.S. government, extends the investors' rate of return.

Many well-known names in modern business, when they were just small businesses or start-ups, were financed by the SBIC investment funds licensed by SBA, including, for example, FedEx, Gymboree, and Outback Steakhouse. This program model was identified for use overseas about a dozen years ago by the Overseas Private Investment Corporation, which adapted the SBIC model to launch its Investment Funds program.

But the President directed us to tackle the challenges of financing large-scale businesses that can turn around whole economies in distressed communities here in America, calling these places "our greatest emerging markets." And he turned to HUD for its experience in leading large-scale revitalization and to SBA for its expertise in venture capital financing.

For thirty years, HUD has used a wide variety of financing tools, including the flexible Community Development Block Grant (CDBG) and related loan guarantees, to help communities expand the job base and tax base, set distressed neighborhoods on the path to recovery, and more. Five years ago, we added the innovative Economic Development Initiative (EDI) grants that increased community use of the Section 108

Economic Development Loan Program, wherein communities borrow, with a Federal guarantee, using their future CDBG allocation as collateral.

Together, EDI and Section 108 have financed highly successful, high impact community economic development across the land, from the full-service Minyard Supermarket in an African-American community in Fort Worth, Texas to a supermarket-anchored retail center right here in Anacostia that was developed by a community-development corporation and the state-of-the-art "Learning and Work Complex" developed n partnership with Cessna Aircraft, where over 200 high-wage jobs have gone to adults in the transition from welfare to work.

HUD knows how to facilitate large-scale community and economic development and how to handle the complex real estate transactions that are so often central to that development. But we want to do more than we can with our current tools, first because there is never enough grant assistance to meet the need, or fund every worthy project, and second, because we didn't feel we were doing all we could to directly stimulate the private sector. APIC will create big private funds to do a big job. It will create a national network of such institutions, which focus on identifying, evaluating, and investing in the most promising targets for private equity to grow business. Period. We've never created such a crop of private institutions to take on this work.

But there's more to the model than licensing entrepreneurial fund managers and leveraging their equity to create larger capital pools. The key is that the taxpayer is protected. Every dollar of private equity capital must be lost before the government guarantee kicks in. This ensures that private fund managers will make market-driven decisions. Government gets involved merely to ensure that the program is functioning according to its intended purpose; it does not second guess the financial wisdom of the private investment funds.

As the former Mayor of Laredo, Texas, a fast-growing city with deep distress in some neighborhoods, I can tell you—we could have used APIC when I was in City Hall. First, we needed a tool for expanding partnerships between our local government on one hand—with all the tools it can bring to bear to make development successful—and private investors on the other. Second, we needed—and our Nation's communities need today—ways to extend scarce community economic development grant dollars, much of which is provided by HUD. Third, we needed equity capital to place that first bet on promising growth businesses so that banks would come in on important investments.

Given this firsthand experience, it re-assures me that our design for APIC is solidly aimed at responsiveness to the private investor without in any way discouraging existing Federal, State, or local economic development aid where they are available. APIC is non-bureaucratic and would be fully additive to existing tax credits, grants, loan guarantees, and other forms of economic development assistance. It replaces none of these and has the power to extend the impact of all of them, again by adding private equity capital to the equation.

While the value added by APIC to the existing Federal toolbox is vital, what APIC would do for major private sources of capital is just as important, because for the first-time, we would be offering banks, pension funds, insurance companies, major corporations, foundations, State and local governments, and others a vehicle for making large-scale equity investments that are socially responsible but yield attractive returns. APIC is the infrastructure; it would create a highway for driving large amounts of equity capital to places in the economy that have room to grow—with untapped land, labor, retail demand, and other assets—but too often lack the capital, and especially the equity, to make that growth happen.

Our expectation is that some investment companies would propose a regional focus, giving major employers, area banks, and others opportunities to act as good neighbors while re-investing in the region's competitiveness. Other APICs might be national in scope, and some might focus on particular business sectors, such as inner-city retail or rural high technology manufacturing or data processing.

The $20 million in credit subsidy appropriated for APIC in HUD's FY2000 budget would allow us to guarantee an estimated $556 million in private debt, leveraging an additional $278 million in private equity. That's $834 million of private capital and many thousands of jobs at a cost to the taxpayer of just $20 million. A $20 million investment by the taxpayer yields $834 million of venture capital funding for these businesses, and the SBIC and OPIC programs show that it works. We look forward to working with the Committee to authorize this important program and employ this $20 million.

Thank you again for your time this morning. Our Administration looks forward to working with Speaker Hastert, you Mr. Chairman, the Ranking Member, and other leaders in helping make the New Markets agenda a reality, including APIC, the New Markets Tax Credit, and the New Markets Venture Capital Companies. Secretary Cuomo is excited at this opportunity, and my colleague Xav Briggs and I stand ready to answer any questions you may have.